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## THE MASSACHUSETTS BUSINESS CORPORATION LAW.

THE Massachusetts Business Corporation Law, enacted by the legislature of 1903, has been the subject of discussion and criticism by no means limited to the State. The charge has been made that in the enactment of this code the conservative State of Massachusetts has at last surrendered to the demands of promoters, and has joined the States which vie with each other in bidding for the privilege of giving charters to irresponsible corporations. It is the purpose of this article first very briefly to point out the causes leading to the enactment of a new corporation law in Massachusetts, and then to discuss those features of the law which distinguish it from the more recently enacted corporation laws of other States and to indicate its probable influence upon the organization and legislative regulation of industrial corporations.

The fundamental reason for the enactment of the new law is to be found in the defects of the previous legislation of the State relating to business corporations. The groundwork of this legislation had survived nearly a hundred years since the earliest legislative regulation of such forms of organizations. Successive amendments permitting incorporation without special act of the legislature, the payment of stock in property as well as in cash, and finally, as to certain classes of corporations, an unlimited capitalization, were obvious concessions to the demands of developing business methods. These amendments left the law, however, in form a mere patchwork, and in substance neither a real protection to stockholders or investors nor sufficiently liberal in some respects to attract the incorporation of business enterprises organized and financed in the State. During the past five years the advantages offered by the more liberal corporation laws of other States have been availed of to a constantly increasing extent

until in the year 1901 two business corporations were organized under a foreign charter for the purpose of doing business in Massachusetts for every such corporation organized under the laws of the State.

Business men felt a certain degree of resentment in being advised to organize their corporations outside of their own State, and a movement was set on foot in the early months of 1902 to secure, if possible, some relief. Under a legislative resolve passed in that year, Governor Crane appointed a special Committee on Corporation Laws, which, after many public hearings and a very careful investigation of the subject, reported to the legislature in January, 1903, the draft of a Business Corporation Law which was subsequently enacted without substantial amendment, with the exception of one provision relating to taxation.

It was the avowed purpose of the special committee upon which much of the responsibility for this new law must rest to draft a law which would permit, under conditions generally as favorable as could be secured under a foreign charter, the incorporation under Massachusetts laws of business enterprises financed by Massachusetts capital. The new law certainly was not designed to increase the revenues of the State. Under the old law Massachusetts collected from both business and public service corporations a larger franchise tax for the year 1901 than was collected in that year from the same source by any other State except New York and New Jersey.<sup>1</sup> It can be stated with equal positiveness that it was not the inten-

<sup>1</sup>The amounts received in 1901 from the taxation of corporate franchise of business and public service corporations, as reported by the Massachusetts Committee on Corporation Laws, *Report*, pp. 299-303, are the following:—

New York . . . . .	\$4,966,680.93
New Jersey . . . . .	1,633,074.19
Massachusetts* . . . . .	1,271,316.23
Pennsylvania . . . . .	1,005,184.23
West Virginia . . . . .	322,078.50
Maine . . . . .	39,225.00

\*The receipts from business corporations reported by the Committee on Corporation Laws were \$331,434.38. The balance represents receipts from public service and other corporations reported by the Tax Commissioner. *Report*, 1901, p. 8.

tion of the framers of the new law to place Massachusetts in the position of being a competitive rival for the business of incorporating enterprises financed and doing business exclusively outside of the State, or of drafting a law "which will be favorable to the organization of large corporations popularly known as trusts."<sup>1</sup> How far Massachusetts has succeeded in adopting a corporation code which, on the one hand, will attract the incorporation of the legitimate business enterprises in which its citizens are interested, whether designed to do business within or without the State, and yet will discourage the organization of inflated promotion schemes and adequately protect both the stockholder and creditor, can best be determined after considering in some detail those provisions of the new law which are particularly designed to accomplish these ends.

Although the subject of the taxation of corporations occupied by far the largest share of the consideration of the special committee, the recommended changes in the existing law are few in number. The existing theory, of a tax levied by the State indirectly upon the stockholder on the market value of his stock, has been retained, not because the theory upon principle commended itself especially to the committee, but for the practical reason that any other rule which could logically be adopted would very largely increase the amount of taxes paid by more than half of the existing Massachusetts corporations. The legislature so changed the recommended draft of the new law as to enable the organization of Massachusetts corporations for the purpose of doing business outside of the State without being subject to undue taxation, and also to make possible the organization of corporations to hold the securities of Massachusetts companies. The legislature also added a limitation of the maximum value of the taxable corporate franchise to an amount not exceeding 120 per cent. of the actual value of the tangible assets of the corporation. While this amendment will reduce somewhat in the first instance the revenue of the State from its

<sup>1</sup> *Report of Committee on Corporation Laws*, pp. 24 and 61.

corporations, it was believed to be necessary in order to retain in the State some of its most successful corporations, and to attract business enterprises which otherwise might hesitate to incorporate under a Massachusetts charter for fear of the operation of an unlimited tax upon that portion of the value of their capital stock representing intangible assets. The provisions of the new law relating to taxation are, therefore, a re-enactment of the former laws, with amendments which will prevent double taxation and place Massachusetts as nearly as possible on a basis of equality with other States in this particular.

Corporations organized under the Business Corporation Law are permitted the largest degree of freedom in conducting their business consistent with a sufficient protection of the interests of minority stockholders. All corporate action can be taken upon the affirmative vote of a majority in interest of the stockholders, except such action as may affect the value of the stock. It should be noted, however, that the creation of a new class of stock, or its sale, lease, or exchange, requires the concurrent vote of two-thirds of the stockholders. At organization almost any scheme regulating the classification, powers, and voting rights of the stock of the company, may be lawfully adopted. The stockholders' and directors' liabilities are reduced to correspond in the main with those prevailing in most of the other States. The requirements of the former law relating to the annual filing of certificates of condition by domestic and foreign corporations have been retained. The machinery by which stockholders may secure information as to the doings of the corporation has been made more effective. It was the purpose of the committee to draft a law in this particular which would enable any stockholder who, in good faith, desired information, to secure it without delay or unnecessary expense, while, on the other hand, the law would protect the corporation from inquisitive annoyance, instigated perhaps by hostile motives.

In relation to foreign corporations, Massachusetts has

followed the lead of several of the Western States in attempting to place upon an equal basis, so far as possible, the corporations organized under its own laws and those organized under foreign charters. Rather as a means of demanding recognition than for the purpose of securing a larger amount of revenue, an excise tax has been imposed upon foreign corporations. As this tax amounts to only one-hundredth of one per cent. upon the authorized capitalization, and as corporations are permitted to deduct from this amount whatever taxes are locally paid by them, the tax will practically affect those corporations only which under the old law conducted their business in whole or in part in the State without directly paying any tax whatever in return for the privilege which the State as a matter of comity extended to them. As the maximum tax to be paid is limited to two thousand dollars, it is not expected that even the larger industrial corporations will be deterred from doing business in the State. It is believed that with the imposition of this nominal excise tax will come an increased degree of responsibility from the State towards foreign corporations; and, inasmuch as no action can be maintained in its courts by foreign corporations until this tax is paid and the annual certificate of condition filed, it is hoped that the new law will inspire a greater respect for the legislative requirements of the State than has been evinced during the past few years by such corporations.

From an economic point of view these features of the Business Corporation Law are overshadowed in interest by its provisions relating to the issue and payment of capital stock. The attacks which have been made upon the new law have been focussed upon the fact that it permits the unlimited capitalization of intangible assets,—“wind and water” is the more popular expression among the critics of the law. It may, then, be profitable to consider this provision of the new law in some detail.

Logically there are the three following theories upon which statutory provisions relating to the payment of capital stock by property conveyed to the corporation can be based:

1. That the incorporators are the judges of the value of property to be conveyed to the corporation in payment of stock, and that the State has no interest or duty in the matter except to create a liability for fraudulent action. This is the most generally accepted theory of the more recently enacted corporation laws in this country.

On this theory, in the absence of actual fraud, the judgment of the directors is conclusive. Even if fraud can be proved, which has only rarely been accomplished, the title to the stock in question cannot be attacked; and the only remedy is a personal one against the fraudulent directors. The practice, so widely advertised in connection with the receivership proceedings of the United States Shipbuilding Company, of electing irresponsible dummies to protect the parties to fraudulent proceedings from any danger of personal liability, is by no means unusual. The most obvious defect in this legislation is that the facts concerning the issue of stock for property are hidden in the records of proceedings of the board of directors to which the stockholder or prospective investor has no access. He is unable to form an independent judgment as to the value of the property of which his stock represents a fractional interest. He is guided in making his investment solely by the more or less misleading statements contained in a prospectus and by the equally fictitious quotations which manipulation in the stock market can give to such securities when issued and listed on a stock exchange.

2. The second theory relating to the payment of capital stock in property is that the issue of stock so paid for must be controlled and limited by the State. This theory has been logically adopted in the existing legislation in Massachusetts, so generally and justly commended, relating to the issue of securities by public service corporations. It has been asserted that it governed also the issue of stock of business corporations under the law now repealed by the Business Corporation Law. But this assertion would not be made by any one familiar with its administration.

The earlier law provided that capital stock might be is-

sued for property to the extent sanctioned by the Commissioner of Corporations. This commissioner soon found it necessary to establish certain rules in regard to the subject. One was that no stock could be issued for patent rights or other intangible interests. This rule was conservative, and worked substantial justice in a majority of cases. In some instances, however, patent rights have proved to be very substantial assets from the point of view of the investments which they represent and the dividends which they can earn. In at least one case a well-established business in Massachusetts was compelled to secure a special act of incorporation from the legislature in order to make possible a partial capitalization of its very valuable good will.

As the statute provided no machinery, and as no appropriation was allowed, for securing a fair appraisal of the tangible property to be conveyed to the corporation in payment of its stock, the Commissioner of Corporations has always required a sworn statement to be made as to the value of property for which it is proposed to issue stock. This statement has been accepted by the commissioner, in the absence of further information, as a basis of his appraisal. The practical effect of this practice has been to enable incorporators to fix their own valuation of property for which stock is issued, as is the almost universal rule in other States. That the former law was unsuccessful in guaranteeing the success of corporations organized under its provisions is well indicated by the fact, as the writer has been informed, that nearly 75 per cent. of the corporations which have been reported insolvent to the United States courts for the district of Massachusetts during the past three years have been organized under laws of that State. It may fairly be said, therefore, that under the former law the State in attempting to be sponsor for the solvency of private corporations organized under its provisions failed signally to accomplish the intended results. There can be no middle way. The State must either undertake an examination by its own experts of the value of the prospec-

tive assets of the corporation or it must not pretend to do anything of the kind.

There is much to be said in favor of such an appraisal in the case of public service corporations. The State in this case has granted valuable franchises, and in many cases protects the corporation from disastrous competition. It may well be argued that in return it is the duty of the State to see to it that these franchises are not sold to the investing public at an unfair valuation. There is no such reason for protecting the investors in business corporations where competition is unlimited and the only right given by the State is the right of existence. In this class of corporations the State cannot afford to undertake for the benefit of prospective investors—many of whom, perhaps, are not its citizens—an appraisal for which it will be held responsible. If all the facts necessary to enable individual investors to exercise their own judgment as to the value of the securities of private corporations are required and enforced by suitable legislation, the State has done all that can be required of it.

3. The third theory, and the one adopted in the new Massachusetts law in regard to the duties of the State in regulating issue of stock for property, is that, so long as incorporators are not acting fraudulently, they may capitalize any property, tangible or intangible, at any amount they desire, provided that no stock may be issued at or after organization until a statement has been prepared and placed upon public records, showing the amount of stock which has been issued and the exact manner in which it is paid for. If the payment is in cash, the facts will be so stated; if in property, a description of the same must be included in the statement, which will be sufficient for purposes of identification; if stock is to be issued for services or expenses, their nature or extent must be set forth. On this theory prospective stockholders and creditors deal with the corporation at their own peril. The State does not assume either to give its sanction to a "blind pool," as it may be said to do under the first theory mentioned,

or to guarantee, directly or indirectly, the value of the property for which capital stock is issued, as it may be said to have done under the former law.

Publicity, therefore, and not paternalism, is now adopted in Massachusetts as its remedy for the evil of over-capitalization. A public statement sufficient to acquaint prospective stockholders with the facts concerning the property of which they may become part owners is, under the new law, a condition precedent to the legality of stock issued. Directors are liable, as in other States and as they were liable under the former law in Massachusetts, for making statements which they know to be false. This protection, however, is merely secondary. If investors and speculators purchase, or make advance payments on a speculative purchase by a broker, of a fractional interest in property which is described to them with sufficient detail for purposes of identification, they have themselves to blame if they pay too high a price for it. And when the investor has thoroughly learned his lesson, which can only be taught by experience, he will be able, with the assistance of legislation based upon the theory now adopted by Massachusetts, to make a search of the facts relating to the value of stock in which he is interested, with much of the same thoroughness which he now shows in examining the title to real estate.

At least for the present, the affirmative requirements of the new law relating to publicity, both in regard to the payment of capital and in the matter of annual statements of financial condition, will probably deter the incorporation in Massachusetts of the larger industrial organizations. The practical prohibition against the organization of corporations to hold securities other than those of Massachusetts companies, while not primarily designed for this purpose, is another very practical reason why the very large industrial corporations will continue to organize outside of that State. Finally, the requirement of the minimum State corporate tax of one-tenth of one per cent. of authorized capital, without allowing, as is the practice in many of the so-called "corporation States," very large deductions

for enterprises of large capitalization, in itself is sufficient to discourage the organization of such corporations. It was estimated by the special committee<sup>1</sup> that the United States Steel Corporation would, under this provision of the Massachusetts law, pay an annual tax of over six hundred thousand dollars as compared with its present annual tax in New Jersey of less than sixty thousand dollars.

The effect of the new law in attracting the incorporation of new companies and upon the revenues of the State cannot be definitely determined until it has been in effect for at least a year. The results already shown are gratifying to its friends. The following table indicates the number and the total capitalization of corporations organized under the Business Corporation Law from August 1 to November 1, 1903, with the amount received by the State for organization fees. The figures for the corresponding period in 1902 are also given as a basis of comparison:—

	<i>Number of Corporations.</i>	<i>Total Capitalization.</i>	<i>Fees.</i>
1902 . . . . .	44	\$1,015,800	\$550
1903 . . . . .	200	\$12,481,100	\$3,953.73

Of the newly organized corporations, one is capitalized for \$1,500,000, one for \$800,000, four with a capital of \$500,000, six with a capital of \$250,000, and the remaining ranging down to the minimum of \$1,000. In November an industrial corporation was incorporated with a capitalization of \$5,900,000 to take over, under a plan of reorganization, the assets of a large industrial business operating chiefly in Massachusetts, formerly incorporated with a larger capitalization under the laws of New Jersey.

These figures show that the new law has already become acceptable to the organizers of the smaller partnership corporations. That more corporations with a larger capitalization have not already been organized is not surprising in view of prevailing financial conditions and the probable unfamiliarity of the business interests of the State with all of the advantages of the new law.

<sup>1</sup> Report of Committee on Corporation Laws, p. 63.

It will probably never be possible to enact a corporation law which will entirely solve the problem of giving sufficient freedom to the promoters of the enterprise, adequate protection to its stockholders, and an equitable tax to the State which is responsible for its creation. It certainly will not be possible to frame such a code in this country until a national law can constitutionally be enacted. In emphasizing the necessity of publicity in relation to the question of capitalization, and the opportunities of regulation by taxation, in the case of foreign corporations, Massachusetts has, by the enactment of its Business Corporation Law, at least pointed the way which must be followed in future legislation.

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